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SUBJECT: UKRAINE: EBRD TO SEEK EUROPEAN RESPONSE TO BANKING CRISIS

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¶1. (SBU) Summary. EBRD senior advisor Piroska Nagy told us on January 28 that her bank hopes to establish a common European response to the banking crisis in Ukraine and elsewhere in central and eastern Europe. The EBRD would take equity stakes in, or provide debt financing to, the Ukrainian subsidiaries of European banks. In return, the parent European banks would agree to stand by their Ukrainian subsidiaries by rolling over debt coming due this year and by increasing their capital. The EBRD would also require assurances from the National Bank of Ukraine (NBU) and the GOU that the regulatory environment and the NBU's foreign exchange and refinancing policies would become more transparent and fairer to foreign banks. End summary.

EBRD Prepared to Supply Equity, Debt to Ukrainian Banks
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¶2. (SBU) Nagy said the EBRD has budgeted 1.1 billion euros over the next two years to finance either equity stakes or debt financing to banks in troubled central and eastern European countries. She said the European Investment Bank (EIB) and World Bank subsidiary International Finance Corporation (IFC) would support EBRD efforts and loan to Ukrainian subsidiaries of European banks as well. To gain support for the plan, the EBRD has reached out to the headquarters of parent banks in western Europe, and it is working to bring together the GOU and NBU with regulators in the countries of the parent banks. A first meeting of regulators and governments took place on January 23 in Vienna, and the EBRD met with parent bank representatives of Ukrainian subsidiaries, along with senior leadership of the National Bank of Ukraine (NBU) and the Ministry of Finance, on January 27 in Kyiv.

¶3. (SBU) Nagy told us that the recently completed diagnostic audits of the country's largest 17 banks (reftel) will require them to increase their capital by about $3 billion. Of this sum, $1.8 billion will be needed by the Ukrainian subsidiaries of foreign banks. The EBRD will be prepared to provide some of the needed capital by taking stakes in the Ukrainian subsidiaries, if the parent companies also pledge to support their banks in Ukraine.

¶4. (SBU) The EBRD is prepared to provide loans to Ukrainian banks, both foreign and domestically owned. Nagy pointed out that about $17 billion of foreign debt issued by banks in Ukraine is coming due in 2009. The EBRD estimates that roughly half of that sum is debt owned by Ukrainian subsidiaries to their foreign parent bank, although Nagy said the exact figure was difficult to determine because of weak NBU methodology. Most of the remaining debt takes the form of syndicated loans, which are now distributed among many lenders in the European capital markets.

How Committed Are Foreign Banks to Ukraine?

¶5. (SBU) Nagy was guarded when asked whether foreign banks would deliver the needed capital and debt financing to their Ukrainian subsidiaries this year. In general, foreign banks were prepared to maintain their presence in Ukraine and support their subsidiaries as needed. She was more confident that foreign banks would provide capital to their Ukrainian subsidiaries, because the NBU had the institutional leverage to compel them to do so. The NBU could threaten to revoke the license of the subsidiary if it failed to meet newer, higher capital requirements. Although foreign banks were also generally prepared to roll-over loans to their Ukrainian banks, the worsening economic crisis could make it more difficult for them to do so, and Ukraine might not be the top priority for many banks that have significant exposure throughout the emerging banking markets of central and eastern Europe, Nagy said.

¶6. (SBU) Still, the EBRD had not seen any indication that foreign banks were reconsidering their engagement in Ukraine, although EBRD economist Alex Pivovarsky, who accompanied Nagy to the meeting, said that mergers or sales of foreign-owned banks were a distinct possibility. In any case, foreign banks were demanding a more consistent and equitable regulatory environment, Pivovarsky and Nagy said.

¶7. (SBU) According to Nagy, the EBRD would require specific commitments from both the NBU and GOU. In particular, it would expect that NBU refinancing of banks would be transparent, non-discriminatory and conform to internationally accepted practices. EBRD would have similar expectations with respect to the NBU's foreign exchange operations. Both the NBU's refinancing and foreign exchange operations have come under criticism in recent

months, with many observers arguing that the NBU's non-transparent, and often unexplainable actions, were actually benefiting a small group of privileged insiders.

TAYLOR